"DULCIUS EX ASPERIS" – HOW CASH POOLING WORKS IN THE CZECH REPUBLIC*

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Received: 9. 6. 2006
Accepted: 16. 11. 2007

Professional paper
UDC: 336.7 (437.1)

This paper outlines the changing financial scene in The Czech Republic, which is following the global pattern of institutional investors taking over the role of commercial banks as relationship banking is gradually giving way to transaction-driven banking. Investment-grade companies have become more reliant on direct financing and less reliant on intermediated financing. This is due both to reluctance by banks to extend credit facilities to high-grade corporate clients, as they search for more lucrative returns on capital, and by the growth in the supply of capital by institutional and other non-bank investors. This growth in direct financing has been predominately in the form of unsecured and unregistered commercial paper issues. The relatively high Czech reference interest rates in the late 1990's influenced the development of company debt financing, forcing companies to become more sophisticated and dynamic in their use of debt instruments and hedging tools as they attempt to manage the subsequent interest rate risk. The objectives of cash management are straightforward – maximise liquidity and control cash flows and maximise the value of funds while minimising the cost of funds. The strategies for meeting such objectives include varying degrees of long-term planning requirements. Also, like everywhere in the world, much treasury activity in the Czech Republic is concentrated on cash management. This includes financing the corporation, administration of debts (loans, bonds, commercial papers, etc.), good relationships with the banks, payments to suppliers

* This paper benefited greatly from discussions with Mr Vit Sigmund. The paper is published due to the Czech Grant Agency support (grant GACR No. 402/05/2758 "Integration of the financial sector of the new EU member countries into the EMU").

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and collections from customers, control of foreign currency and interest positions according to the company's needs for finance, and finally the reporting and technical support of all these functions. In this context, the use of cash pooling as a global standard for concentrating cash into the main bank account of the firm, has very quickly found favour in Czech corporations.

1. INTRODUCTION

The objectives of cash management are straightforward – maximise liquidity and control cash flows and maximise the value of funds while minimising the cost of funds. The strategies for meeting such objectives include varying degrees of long-term planning requirements. Also, like everywhere in the world, much treasury activity in the Czech Republic is concentrated on cash management. This includes financing the corporation, administration of debts (loans, bonds, commercial papers, etc.), good relationships with the banks, payments to suppliers and collections from customers, control of foreign currency and interest positions according to the company's needs for finance, and finally the reporting and technical support of all these functions. The use of cash pooling as a global standard for concentrating cash into the main bank account of the firm has very quickly found favour in corporations in the Czech Republic.

Globally, cash pooling is a bank product that enables a group to collect money and use it for either further investment or lending. The product is available to companies, which are part of a group of economically related parties (We cannot use the word 'concern' because the Czech codes do not recognise this word in the legal sense.). Related parties are business entities that are related by share ownership. For cash pooling business, it is necessary for them to sign a collective agreement to operate a so-called major (master) bank account. Other bank accounts are settled toward this master account. There could be an overdraft agreement with a bank, but this is not possible for either a master account or the other bank accounts in the pooling system. Nevertheless, credit or debt interest rates have to be defined for all accounts. There has to be an agreed level of interest rates between the bank and the companies involved in the cash pooling system and between each of those companies, too.

2. TYPES OF CASH POOLING AVAILABLE

Banks in the Czech Republic generally offer the following types of cash pooling:

- real (zero-balancing) cash pooling,
- fictive (notional) cash pooling,

- multicurrency cash pooling,
- cross-border cash pooling.

2.1. Real cash pooling

Real cash pooling is based on a transfer from bank accounts to a master account, with balances on all bank accounts except the master account being zero at the end of the working day. It means this money physically 'moves' from the junior accounts to the master account.

2.2. Notional cash pooling

Notional or fictive – because money stays in the bank accounts and the calculation of interest rates is based on fictive consolidated credit or debt bank balances. There is no money transfer between the accounts of the companies involved in fictive cash pooling.

2.3. Multicurrency cash pooling

Bank account balances in different foreign currencies are swapped to one agreed currency, which is the base for the interest rate calculations.

2.4. Cross-border cash pooling

Cross-border cash pooling helps corporations avoid the bureaucracy intrinsic to transferring cash across countries and different clearing systems, as well as different legal entities and the headache associated with the additional inter-company loan administration. While there is a selection of solutions in the marketplace, most of these operate on an interest enhancement basis where corporations are rewarded for servicing their liquidity through their chosen bank, but the bank is unable to achieve a balance sheet offset due to the complexity of multiple jurisdictional and regulatory barriers. Czech banks now offer cross-border pooling, both notional and real, for accounts in the domestic Czech koruna, euro, US dollar, Central European currencies (such as in the Slovak koruna, Hungarian forint and Polish zloty) and pound.

From our point of view, these principles are used both in the Czech Republic and in the rest of Europe, and are therefore similar; any differences are the result of the legal requirements of each country. As mentioned above, the Czech Commercial Code does not recognise anything like 'concern' or a product like cash pooling. It is necessary to fulfil several conditions to prevent

problems concerning taxation and reporting to minority shareholders. It is practically impossible to implement a cash pooling agreement between companies without a majority share. It is normal practice that a cash pooling system has to be agreed by a general meeting of the company and there is a strict requirement for signed control agreements. Sometimes, it is necessary to change the company articles of incorporation.

3. EFFECTIVENESS OF THE CASH POOLING

The first possible viewpoint is a viewpoint according to the type of company where the cash pooling system is to be used. The first case is use within the scope of one company with a number of individual organizational units (plants), where pooling enables the effective management of financial means even during a requirement for the decentralisation of the organisational units. The second alternative is use within the scope of a holding company with independent accounting units – companies in the group. Here, pooling makes the management of finances more effective from the accounting and administrative aspect from the beginning of separated units.

The second viewpoint of the use of pooling is according to the initial purpose. From this aspect, it is possible to divide pooling into pooling for associating cash and into pooling for making financing more effective. The first use accents the improvement of the possibility of investing free financial means during a greater volume of these. The second alternative is the possibility of use of the free resources of one unit for the financing of other units without bank loan costs.

Which independent companies actually use cash pooling? They are any company which requires that financial management of organizational units is kept separate and fully transparent. They are also companies that base their assessment on the realized cash flow of organizational units. An example would be the FMCG companies, industrial companies within individual plants or financial institutions with regional branches such as insurance companies for instance.

Each such company must determine the degree of independence of its organizational units. Independence can be complete within the scope of an annual plan in the sphere of income and expenses, or independence is limited in the sphere of expenses by a certain annual budget and in the sphere of income by the task of achieving the planned cash flow (the most usual case).

4. POOLING STRUCTURES

The used type of pooling structure is determined according to this differentiation. Within the scope of one company and one country, the most effective system is zero balancing because it performs the complete centralization of financial means. If the individual branches fulfil simply the income part of the budget and the expenses are centralised, it is suitable to perform transfers in only one direction. Single-direction zero balancing is the system most used. With regard to the overdraft limit in this arrangement, this is not allocated on the level of individual accounts (organizational units) and usually serves only on the master account level for covering cash flow deviations. If the branches are not an income but a cost centre, it is suitable to enable either drawing of an overdraft limit from their accounts or to subsidise them by a certain sum each day. If costs are approximately the same every day, it is appropriate to use dual-directional pooling with the retroactive transfer of the defined amount of the daily budget. This arrangement can also be used during the management of branches governing income and expenses if the expenses fulfil the requirement of stability. In this arrangement, we do not allocate an overdraft limit on the level of the individual account. The management of branches issues from the determined daily budget. The overdraft limit on the main account serves for the purpose of the centre and for the cases of non-coverage of expenses of a branch by the income from elsewhere.

In cases of cost branches, which have variable expenses during a measure of days, but stable expenses within the scope of the month, it is possible to select from several various arrangements. One alternative is to transfer the whole volume of the monthly budget to a secondary account and monitor the volume of submitted payment orders in the centre (must be monitored by the company information centre). The second alternative is to enable the individual account to draw an overdraft of up to the sum of the monthly budget. Again, the company information system must monitor either the volume of submitted payment orders (the more complicated alternative) or the volume of transfers from the top account to the secondary account. This alternative is also offered by some banks within the scope of real pooling. Their system enables automatic monitoring of the cumulative volume of transfers between the top and individual account and if the overall cumulative limit for drawing is exceeded, it does not allow drawing of an additional overdraft. If the branch expenses are various even from month to month, it is possible to resolve this problem by regular modifications to the sum of the overdraft limit month by month. In these cases, the overdraft limit of the main account is delegated to individual accounts

and its sum does not have to exceed the sum of limits of individual accounts. It is appropriate to modify the settings of the individual overdraft limits according to the updating of the annual plan of expenses.

In the event that the organizational unit governs income and expenses, a combination of the mentioned approaches is necessary. The simplest method is the alternative of profit centres, when expenses must be covered by one's own income of the unit. Subsequently, the most suitable solution is dual-directional pooling with retroactive transfer of the transferred balance. For better coverage of the cash flow, the branch may be set an overdraft limit. If the branch has limited stable daily expenses, the already mentioned alternative of retroactive transfer of the target sum is appropriate. If we wish to limit the variable expenses and the branch also has a set income, then it is appropriate to plan the acceptable negative difference within the certain period between income and expenses and to enable the cumulative drawing of an overdraft for this amount during the course of the period.

All the above given types of use of pooling allow for pooling in one currency. This is the most usual type because conversion operation costs do not exist. Pooling with conversion usually also brings such great expenses that it is not worth it for larger amounts. Consequently, it is better to divide organizational units so that they work with the smallest possible number of currencies (with a minimum of accounts). If they work with multiple currencies, it is appropriate to again structure each currency according to the responsibility and character of income and expenses of the given branch as was mentioned above.

5. POOLING WITHIN A HOLDING STRUCTURE

Naturally, international companies use cross-border pooling and associate liquidity in individual currencies in their 'nostro' accounts serviced by the central treasury of the company. Use in the case of holding companies is more complicated, particularly as a result of the legal problems which exist in the Czech (domestic) environment and for reasons of greater decentralisation of information and functions than in one company. On the other hand, the range of purposes for which cash pooling can be used is expanded by tax optimisation, in-group financing according to the rules dictated by the owner and not the bank and in-group risk management thanks to netting positions in individual currencies.

Cash pooling used within a holding is based in the acquired controlling share in subsidiary companies. Individual participants of the pool may have (but do not have to have) mutual financial flows. However, their existence makes use of the pooling structure more effective if mutual settlements are performed within the scope of one bank and one pooling. The central treasury may, in such cases, take two different standpoints.

Either, it can completely omit management of in-house receivables and payables and monitor only external positions because in-bank transfers do not change the overall position of the pool, or the second possibility is the decentralisation of settlement of in-group items, when all in-group payments are initiated by a centre. This naturally also performs the potential netting of payments by means of setting off. The highest level of centralisation is the arrangement of the cash flow within the scope of an in-company bank, which maintains accounts of individual companies and performs operations on the internal accounts of these companies. The whole company has a single account for external relations. This naturally minimises costs for the whole administration of current accounts and payment orders. Of course, the relevant account exists for each currency and is situated in its home country so that the best conditions for domestic payment relations and the best conditions for storage of excess or drawing loans are achieved. All company accounts are placed with a single worldwide financial institution so that the fastest possible international coverage of financial needs is possible. Certainly, multiple accounts may be used for some currencies if the establishment of these reduces costs (see for example Single European Banking Market).

The problem of individual subsidiary companies or plants is resolved by a system of identification symbols for individual organizational components. The internal treasury system then maintains imaginary internal accounts for individual divisions or subsidiary (affiliated) companies and performs all in-company or in-group settlement simply by the transfer to these imaginary accounts. Consequently, a significant amount of bank fees for payment orders is saved. This concept is completely logical and truly maximally economic. On the other hand, in the Czech Republic and elsewhere, it encounters legislative restrictions. In the case of one company, this is not yet such a great problem. However, in the case of the administration of accounts of independent subjects by an internal bank, this centre has the attributes of a bank. It maintains accounts, accepts deposits, provides loans, and performs spot, timed and other derivative operations. Consequently, according to Czech legislation, it should fulfil all the requirements of a bank including a license from the ČNB (The Czech Central Bank). In this case, it is necessary to establish or purchase a

banking institution and create an in-company bank on this basis. This model is applied by some large global (Allianz insurance group) and Czech (PPF group) companies, particularly those that also provide financial services to clients.

For reasons of problems with Czech legislation, the most often used pooling system within the scope of a holding is notional pooling and dual-directional balancing with a retroactive transfer of the same amount. As already stated, notional pooling enables simple compensation of credit and debit remainders and its advantage is the non-existence of any mutual loans; consequently, agreement by the General Meeting or modifications to the Articles of Association are not necessary. All transactions are only imaginary and in-group receivables and payables do not occur. On the other hand, some banks do not wish to provide notional pooling with overdraft frames to holding companies for reasons of the impossibility of netting notional pool positions, which cannot be contractually determined either. The problem would occur in mortgage contracts in the state of accounts of others, which is variable. If one company drawing an overdraft limit became bankrupt, the bank could only involve this company. Even though thanks to the introductions of cross defaults into contracts for loans of other companies, it would be possible to partially involve other members of the holding; the bank would never be restored from the resources of other subjects (naturally with the exception of the mortgage of other assets of the remaining companies; for example, payables). Cross default would only mean the option of declaring the financial means of other companies due payable. The second problem is the problem of bank expenses connected with holding credit remainders, such as statutory minimum reserves and the fund for insuring deposits. Since in a notional pool it is not possible to net positions, the bank's expenses for pooling are increased by these items. However, the higher level of management is zero balancing. Thanks to the overall viewpoint of the group of holding accounts, this leads to a much more effective administration of money. The advantage for the bank is the monitoring of only one loan exposure.

6. INTERNATIONALIZATION

International cash pooling, as has already been mentioned, is any pooling when the transfer of financial means occurs over country borders. The main difference compared to standard national pooling is the need to work with nationally determined exchange rules and rules for payment relations. Furthermore, it is necessary to deal with the matter of transfer quality, speed and costs between individual countries. Due to its complexity and the fact that it is fairly costly, international cash pooling is only worth it for greater amounts.

In spite of this, most international corporations use it and treasuries of international companies in the Czech Republic regularly encounter it. The most usual type of international pooling is real pooling and single-directional pooling. Controlling companies usually prefer the real centralisation of resources and their re-division by means of a centrally secured payment of deliveries. In-company loans, which occur within the scope of real pooling, are subject to central management and settlement in international companies.

7. FINDING AN INTERNATIONAL TREASURY CENTRE

In 2005, a Master student Lenka Simkova, under the direct supervision of one of the authors (Polak), produced a case study of how to find an international treasury centre for a holding company (CGS), with its headquarters in the Czech Republic, which has previously established cash pooling on a national basis in three currencies, three banks and three structures. It has subsidiary companies in 12 countries - in Europe (eight European Union countries + Switzerland), North America (the United States) and Latin America (Brazil, Mexico). The company wishes to expand cash pooling on an international basis and is searching for a suitable site for locating its treasury centres. The company has decided to only pool within the Eurozone. This means countries such as the United States, Brazil or Mexico cannot be considered as possible solution alternatives, which means the choice of where to establish the treasury centre was between the following countries: Austria, Finland, France, Germany, Ireland, Italy, Slovakia, Switzerland, and the UK. The target was to locate the treasury centre in a country that enables the best conditions for cash flow controlling and administration.

The treasury centre should be located in a tax advantageous place. The fee for maintaining an account, transaction fees and prices for foreign incoming and outgoing payments, including urgent payments, should be as low as possible. The offered yield from excesses should be as high as possible.

Setting of criteria

Criteria resulting from target requirements are as follows:

- Bank transaction fees – to minimize
- Prices for foreign incoming and outgoing payments (including urgent payments) - to minimize
- Withholding and corporate tax - to minimize
- Withholding tax for intra-group yield - to minimize

- Reporting requirements - to minimize
- Rating – as good as possible
- Currency environment – euro, but pound or Swiss franc should not be a problem
- Treasury centres – existence of an important treasury centre (this is a very important requirement because the true cross-border cash pooling remains a rare commodity in the marketplace today as banks have struggled to fully understand and manage these issues).

We found, testing all the criteria, that the best variant is to establish the treasury centre for cross-border cash pooling in Switzerland, followed perhaps surprisingly by Finland.

8. CONCLUSION

In the Czech Republic, as with most countries around the world, cash management is one of the most extended treasury department areas. These activities comprise corporate finance, debt administration (loans, bonds, commercial paper and the like), good banking relations, payment systems to suppliers and collections from customers, controlling foreign currency and interest positions to meet the company's needs, as well as technical and reporting support of the above mentioned areas. Cash pooling has very quickly become a part of the Czech corporations' consciousness. Besides domestic notional and zero balancing cash pooling, Czech banks now offer cross-border pooling, both notional and real, for accounts in certain currencies.

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"DULCIUS EX ASPERIS" – KAKO FUNKCIONIRA SUSTAV OBJEDINJAVANJA POSLOVNIH RAČUNA U ČEŠKOJ

Sažetak

Ovaj članak naglašava promjenu na financijskom polju u Češkoj, koja, u skladu s globalnim trendovima, naglašava kako institucionalni investitori preuzimaju ulogu komercijalnih banaka, s obzirom da bankarstvo utemeljeno na dugoročnim odnosima postupno uzmiče za transakcijski orijentiranim bankarstvom. Velike kompanije se više oslanjaju na direktno, negoli na posredničko financiranje. Razlog tome se može pronaći u činjenici da banke sve više oklijevaju u daljnjem kreditiranju velikih klijenata, te traže veći povrat na kapital, ali i u rastu plasmana institucionalnih investitora i drugih nebankarskih institucija. Porast u direktnom financiranju je prvenstveno u formi neosiguranih i neregistriranih izdavanja komercijalnih vrijednosnica. Relativno visoke kamatne stope u Češkoj kasnih 1990-ih utjecale su na razvoj dužničkog financiranja, prisiljavajući kompanije da postanu sofisticiranije i dinamičnije u upotrebi dužničkih instrumenata i alata za disperziju rizika u pokušaju kontroliranja kamatnog rizika. Ciljevi upravljanja novcem su jasni – maksimizirati likvidnost, kontrolirati gotovinske fondove i maksimizirati njihovu vrijednost, te minimizirati njihovu cijenu. Strategije zadovoljavanja ovih ciljeva uključuju različite stupnjeve potreba dugoročnog planiranja. Također, kao svugdje u svijetu, većina rizničkih aktivnosti u Češkoj koncentrira se na upravljanje gotovinom. Ove aktivnosti uključuju financiranje kompanija, dužničko financiranje (zajmovi, obveznice, komercijalni papiri, itd.), održavanje dobrih odnosa s bankama, redovno plaćanje dobavljačima i naplatu potraživanja od kupaca, praćenje pozicija imovine i potraživanja u stranim valutama, zadovoljavanje potreba za financiranjem kompanije i konačno tehnička podrška svih ovih funkcija. U ovom kontekstu, sustav objedinjavanja poslovnih računa kao globalni standard brzo je i povoljno prihvaćen u češkim korporacijama.